

Seattle; Retail Electric

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Seattle; Retail Electric

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US\$210.525 mil mun lt & pwr imp rev bnds ser 2019A dtd 2//20/08/2 due 04/01/2049

Long Term Rating

AA/Stable

New

US\$140.52 mil mun lt & pwr rfdg rev bnds ser 2019B dtd 08/22/2019 due 02/01/2026

Long Term Rating

AA/Stable

New

Rationale

S&P Global Ratings assigned its 'AA' rating to Seattle's 2019 series A municipal light and power improvement revenue bonds and series B refunding revenue bonds. The utility does business as Seattle City Light (SCL). The outlook is stable.

Seattle pledges the light system's gross revenues to the bonds. The city anticipates using proceeds from the 2019 A bonds to finance capital improvements and conservation programs for the system, fund a reserve fund, and pay the costs of issuance. The city anticipates using series 2019 B proceeds to refund all or a portion of the city's series 2010B bonds.

The rating reflects the application of our "U.S. Municipal Retail Electric And Gas Utilities" criteria (published Sept. 27, 2018).

The 'AA' rating further reflects SCL's ability to produce stable coverage and liquidity through various hydrological and economic conditions. Concentration in hydroelectric generation, from both owned assets and power purchases, exposes the city to some surplus sales risks, although it budgets conservatively to minimize the potential effects of this variability. The maturity and diversity of the underlying service area and stable customer base contribute to credit stability, in our view. The rating further reflects our view of the utility's very strong enterprise and financial risk profiles.

The very strong enterprise risk profile reflects our view of the utility's:

- Very strong operational and management assessment, highlighted by primarily hydroelectric assets that are high quality and low cost, with assets and purchased power supply through the Bonneville Power Administration (BPA) offering relatively low-cost supply; the concentration in hydroelectric resources exposes the city to above-average price volatility with respect to surplus sales, although we note the city budgets conservatively for wholesale revenues, offsetting this risk somewhat; the operational and management assessment also reflects management's credit-supportive practices and policies, coupled with its sound rate-setting track record;
- Extremely strong service area economy, highlighted by a large and diverse customer base with low industrial concentration and stable economic fundamentals;
- Adequate market position, with retail electric rates above the state average following several recent rate increases, although we believe SCL's rates are very competitive with those of other large utilities in the region relative to the national average; and

- Extremely strong industry risk assessment relative to other industries and sectors.

The very strong financial risk profile reflects our view of the department's:

- Very strong fixed-charge coverage (FCC) with conservative budget practices, which suggest ongoing maintenance of coverage near historical levels;
- Very strong liquidity that, when including a \$96.9 rate-stabilization account (RSA), totaled \$232 million as of Dec. 31, 2018; and
- Adequate debt and liabilities score, characterized by 62% debt to capitalization. The utility's five-year capital improvement plan (CIP) totals \$1.72 billion, with about 65% (\$1.12 billion) to be funded with debt. We do not expect Seattle's leverage to materially worsen as debt outstanding amortizes and the city funds the balance of its CIP on a pay-as-you-go basis.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that SCL will maintain its current liquidity and FCC levels through rate-stabilization policies, and continued conservative wholesale revenue forecasting. Rate stabilization, in conjunction with the automatic surcharge triggers, should continue to contribute to credit stability, in our view.

Upside scenario

Given SCL's financial forecast that indicates financial metrics in line with historical levels, increasing rates, and its large CIP and additional anticipated debt, we do not expect to raise the rating in the next two years.

Downside scenario

We could lower the rating if the city's additional leverage or rising power supply costs from BPA result in materially higher retail rates or a weakened competitive position that frustrates its ability to maintain liquidity and achieve FCC commensurate with recent years' levels.

Utility Description And Credit Overview

With more than 454,000 customers, SCL is the largest municipal utility in the state of Washington. It provides service within Seattle and surrounding areas of King County, covering a population of about 874,000. The utility's predominantly hydroelectric power supply portfolio is low-cost and carbon-free. It provides power to a stable customer base with access to a broad and diverse economy.

Enterprise Risk Profile: Very Strong

Operational management assessment (OMA): Very strong

In our opinion, SCL's operational management is very strong, highlighted by very strong operational assets; very strong rate setting; extremely strong management, policies, and planning; and strong environmental compliance.

Low generating costs, very high reliance on hydroelectric generation, and surplus generation capacity in most months characterize SCL operations. The system's hydroelectric generating assets are distributed among the Columbia River-based Federal System and two other independent river systems. Owned-generating assets include the Boundary and Skagit river projects, representing 29% and 17% of total resources, respectively. Additional resources include a maximum of 175 megawatts from the Stateline Wind Project and a number of smaller renewable contracts. In our view, SCL's owned assets combined with BPA purchases provide ample energy to meet load demands.

SCL's block allocation under its current contract with the BPA is sized to bring the utility into load-resource balance under critical water conditions, with the goal of considerably reducing supply risk for its retail operations. The system's block product is designed to more closely balance its firm resource requirements. Nevertheless, the city's reliance on owned hydroelectric assets introduces a measure of hydrological and wholesale power market risk to SCL in achieving its financial targets.

Management has taken steps to lower its reliance on wholesale sales to reduce financial performance volatility, and intends to continue doing so. A portion of wholesale net revenues comes from forward sales of typically nine months or less, and SCL maintains strict limits on the portion of its surplus position made available for forward sales to avoid potentially high replacement power costs in low-water years. S&P Global Ratings believes the system's risk management policies are conservative, and adequately reduce the risk related to its forward sales. Furthermore, as part of its strategy, beginning in 2010, city council enacted a series of annual base-rate increases. It also established an RSA to further offset potential revenue volatility. In our view, management has established an excellent track record of rate setting, as evidenced by SCL's historically robust and stable financial metrics, further supported by the utility's two automatic pass-through mechanisms.

The utility updates its long-term strategic plan every two years, and updates its five-year financial and capital forecasts annually. Management also maintains a robust 1.8x debt service coverage policy. Given these policies, coupled with the utility's conservative forecasting practices noted above, we believe SCL's management, policies, and planning procedures are very strong.

SCL's renewable resources comply with Washington's Renewable Portfolio Standard (known as I-937). The utility is required to obtain "eligible" renewable resources equal to at least 9% of its load through 2019 and 15% thereafter to comply with I-937. Management reported that current power contracts will be sufficient to meet the state's renewable mandate under a no-load growth scenario for the next decade. The city forecasts slightly declining load annually because of conservation efforts and energy efficiency evolutions. We believe the costs of complying with I-937 will be manageable given the city's existing power portfolio and management's proactive approach.

The Washington State Legislature passed E2SSB 5116 in May 2019, designed to transition the electricity sector to 100% clean power. The Clean Energy Transition Act (CETA) establishes three standards for Washington State utilities, which include eliminating all coal, requiring utilities to provide 100% carbon-neutral electric service to retail load, and a 100% Clean Electricity Standard by 2045. Utilities will be required to demonstrate compliance with this policy on an annual basis. In our view, given that BPA hydro and incremental hydro appear to qualify, Seattle is well positioned to meet the requirements of CETA.

Economic fundamentals: Extremely strong

The city of Seattle sits at the center of the large, diverse Puget Sound regional economy. SCL's service area consists principally of Seattle, but it also has franchise agreements with several cities in King County and some unincorporated areas. The city's median household effective buying income was 141% of the U.S. in 2018. Although the customer base is primarily residential, about two-thirds of retail sales are to commercial and industrial customers. Total 2018 retail sales of 9,074 gigawatt-hours reflect a 3.5% decline from 2017 figures. SCL forecasts retail sales falling 0.8% per year, on average, through 2024 due to conservation and energy efficiency measures. The customer base is what we consider diverse, with the 10 leading customers accounting for just 14% of total revenues, and no single customer exceeding 3.4% of sales revenue. The city's large size, high incomes, and stable customer base provide the utility a high degree of revenue stability and operational flexibility.

Market position: Adequate

Seattle's weighted overall rates are slightly above the state average, suggesting that despite solid demographics, there are some constraints to revenue-raising flexibility. According to the Department of Energy's Energy Information Administration, the city's weighted average revenue per kilowatt-hour was 111% above the state average in 2017 (the most recent year for available comparative information). Seattle has adopted regular base-rate increases--between 5.6%-5.8%--in each of the past three years. The city also automatically passes through cost fluctuations from BPA, and maintains an RSA surcharge that is automatically applied if the balance of its RSA drops below a certain level. While these mechanisms have supported very stable financial metrics, Seattle's competitive position has also eroded somewhat in recent years. However, the city's high income levels and relatively favorable rates compared with those of other large U.S. cities mitigate this somewhat, in our view.

SCL is projecting total rate increases between 3.9%-5.4% from 2020-2023. Despite these increases, we expect the city will maintain its current competitive position, as several utilities in the state will similarly need to pass through BPA's rate increases.

Industry risk: Extremely strong

Consistent with our criteria "Methodology: Industry Risk" (published Nov. 19, 2013), we consider industry risk for municipal retail electric and gas utilities covered under these criteria very low, and therefore extremely strong compared with that of other industries and sectors.

Financial Risk Profile: Very Strong**Coverage metrics: Very strong**

We view Seattle's FCC as very strong at 1.47x in 2018. Coverage of fixed costs, which include BPA power purchases, has averaged 1.49x over the past three years. The forecast suggests FCC will remain within the current range following yearly rate increases.

Surplus sales accounted for approximately 6% of operating revenue in 2018, and have ranged from 6%-11% of operating revenues. While the exposure to surplus sales introduces greater potential revenue volatility, management has prudent policies in place to mitigate surplus sales risk, as demonstrated by the city's strong coverage and liquidity through various hydrologic and market conditions. As a result, we believe this risk is mitigated and we did not adjust

the coverage metric downward.

Liquidity and reserves: Very strong

Seattle ended fiscal 2018 with \$232 million of available reserves, or 125 days' worth of operating reserves, including a \$96.9 million RSA. SCL draws on its RSA when net wholesale revenue is lower than budgeted amounts. The utility targets a \$100 million balance and automatically enacts a surcharge on its rates to achieve this amount. Management's projections indicate a gradual increase in available reserves, which we believe is reasonable given the utility's conservative budgeting practices and projected rate increases.

Debt and liabilities: Adequate

The debt and liabilities score is adequate, characterized by a 62% debt-to-capitalization ratio. The utility's five-year CIP totals \$1.72 billion, reflecting a 9% (\$214 million) reduction relative to the prior plan. SCL achieved savings by deferring various noncritical system improvements and project cancellations. We do not expect this reduction will materially affect SCL's operational health or flexibility. The utility anticipates funding its CIP with about \$1.12 billion of debt, and the balance with cash and available revenues. We do not expect the city's leverage to materially worsen as debt outstanding amortizes and it funds a large share of its CIP on a pay-as-you-go basis.

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